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Working Capital Management Practices and Firm Performance among SMEs: The Moderating Role of Financial Literacy

Imelda Jeremiah Mville[a*], Mushumbusi Paul Kato[a] and Gabriel Vitus Komba[b]

[a] Department of Marketing and entrepreneurship, School of Business, Mzumbe University, Tanzania,
[b] Finance and Accounting Department, School of Business. Mzumbe University, Tanzania
*Corresponding author
E-mail address: jeremiahimelda@yahoo.com/immville17@mustudent.ac.tz

Abstract

Small and medium-sized enterprises (SMEs) play a crucial role in economic development, yet they often struggle with inefficient working capital management (WCM), particularly in developing economies. Effective WCM, which encompasses inventory, payables, receivables, and cash, can enhance performance; however, the role of financial literacy in this relationship remains underexplored. This study addresses this gap by proposing and testing a conceptual model in which financial literacy moderates the relationship between WCM practices and SME performance. A quantitative, cross-sectional design was used to analyse data from 300 SME owner-managers in Kilimanjaro, Arusha, and Dar es Salaam using PLS-SEM. Direct and moderated links between WCMPs, specifically cash, receivables, payables, and inventory management and business performance were examined using partial least squares structural equation modelling (PLS-SEM). The findings indicate that, unlike receivables management, cash, payables, and inventory management have a positive impact on performance. The relationship between cash management and performance is considerably moderated by financial literacy, which improves liquidity and investment decisions. This moderation effect enhances liquidity management, assessing financial risks and decision-making in resource-constrained environments. The findings emphasise the necessity of contextualised and integrated working capital practices that combine operational proficiency with financial knowledge. Practical implementations include digital solutions for inventories and receivables, financial training for managers, and investments in supplier relations to maximise SMEs' performance.

Keywords: Working Capital Management Practices, Financial Literacy, and Firm Performance.

1.0 Introduction

Small and medium-sized businesses (SMEs) are the main drivers of economic growth in both developed and developing nations. SMEs play a significant role in income redistribution, poverty alleviation, and job creation worldwide. World Bank (World Bank (2023) statistics show that SMEs account for over 90% of all enterprises and provide more than 50% of the world's jobs. They comprise over 95% of all businesses in sub-Saharan Africa and are essential to regional growth and economic inclusivity. However, effective financial management techniques are critical to these businesses' productivity and resilience.

Working Capital Management (WCM) is a fundamental aspect of financial management, crucial for ensuring operational liquidity and the continued viability of business operations. It encompasses

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the strategic management of short-term assets and liabilities, such as cash, inventory, accounts receivable, and accounts payable, to maintain an optimal balance between liquidity and profitability (Boisjoly, Conine, & McDonald, 2020). Effective WCM not only facilitates the fulfilment of financial obligations but also enhances profitability and reduces the cost of capital. Numerous studies have established a strong correlation between sound WCM policies and improved financial sustainability, business growth, and overall profitability (Deloof, 2003; Mogaji & Daniel, 2024). Nevertheless, many small and medium-sized enterprises (SMEs) encounter significant challenges in managing their working capital effectively. These challenges often manifest as cash flow shortages, restricted access to credit, and, in extreme cases, the business's closure. Therefore, advancing financial literacy among SME operators is critical for mitigating these challenges and promoting sound working capital practices.

The low level of financial literacy among managers and owners of SMEs is a significant reason for their poor WCM practices. Eniola and Entebang (2017) argue that understanding financial documentation, creating budgets, and managing debt all depend on having the necessary information and skills to make informed financial decisions. SME managers may not be able to negotiate loan terms, understand cash flow forecasts, or assess the impact of late receivables, which exposes the company to unnecessary financial risks. Because of this, even when SMEs try to implement fundamental WCM practices, their lack of financial knowledge may make those policies less effective (Olawale Fatoki, 2014; Lusardi & Mitchell, 2014).

This problem is especially severe in poor nations, where there is frequently limited access to formal financial education and capacity-building initiatives. In this regard, Sajuyigbe, Ajayi, and Ogundele (2024) contend that SME owners often acquire business skills informally and tend to rely more on their emotions than on financial information when making decisions. This leads to a significant discrepancy between the benefits of WCM as a theory and the real results seen in practice. Although WCM has a strong theoretical foundation and is frequently recognised in SME policy literature, its application remains difficult without sufficient financial expertise (Banu & Sharma, 2023).This study examines how financial literacy influences the link between SME performance and working capital management practices. It argues that financial literacy enhances the strategic management of working capital and promotes more informed financial decision-making, ultimately leading to improved business success. The study fills this knowledge gap by advancing knowledge of how financial capabilities impact operational results in the SME sector. It also provides valuable information for financial institutions, educators, and legislators seeking to support the growth of SMEs by implementing targeted financial literacy initiatives.

2.0 Literature review

A crucial component of financial management, working capital management (WCM) has a significant impact on a company's liquidity, profitability, and operational efficiency. It includes managing cash, inventory, receivables, payables, and other current assets and liabilities. Businesses can maximise their working capital investment to increase returns while maintaining sufficient cash flow for short-term obligations. Deloof (2003) showed that working capital component efficiency and firm profitability are significantly correlated, especially when businesses reduce the cash conversion cycle. Effective working capital management becomes even more crucial for the survival and performance of SMEs, where access to external financing is often limited.

SMEs face particular challenges in managing working capital due to their size and often informal organisational structures. SMEs frequently rely on the experience and instincts of the business owner for financial decision-making, in contrast to larger companies that have access to credit facilities and qualified financial advisors (Abdallah, Harraf, Ghura, & Abrar, 2024). SMEs with inadequate WCM practices are more likely to become insolvent, particularly during recessions or times of low liquidity, according to studies (Eloundou, 2024; Mogaji & Daniel, 2024). Overstocking goods, late receivables, and failing to negotiate advantageous terms with suppliers are common problems. These operational inefficiencies often stem from knowledge gaps in financial management, as well as structural constraints.

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Given the challenges SMEs face in applying effective WCM, improving financial literacy emerges as a vital factor in bridging the gap between financial knowledge and performance outcomes. Better financial practices and increased corporate performance are made possible in large part by financial literacy. Lusardi and Mitchell (2014) proffer that financial literacy is the ability to effectively manage financial resources by applying knowledge and skills. Understanding accounting concepts is only one aspect of financial literacy for SME managers; another is utilising financial information to inform strategic decisions, such as credit policy, pricing, and inventory investment. Financial literacy and prudent financial practices, like proactive financial planning, record-keeping, and budgeting, are strongly correlated (Abdallah, Ali, & Musa, 2024; Sajuyigbe et al., 2024). These practices collectively contribute to better business outcomes. Based on the theoretical underpinnings and reviewed empirical evidence, the study proposes the following hypotheses for testing:

i. *H1: Working capital management practices have a significant positive effect on* firm performance.

ii. H1a: Cash management practices have a significant positive effect on firm performance.

iii.

iv. H1b: Receivable management practices have a significant positive effect on firm performance.

v. H1c: Payable management practices have a significant positive effect on firm performance.

vi. H1d: Inventory management practices have a significant positive effect on firm performance.

The theoretical underpinning of this investigation is the Resource-Based View (RBV), first proposed by Wernerfelt (1984) and, subsequently, formalised by Barney (1991). RBV assumes that a company's internal resources, which are rare, valuable, unique, and non-substitutable, are a source of its long-term competitive advantage. The theory is based on two main assumptions: first, resource immobility, and second, resource heterogeneity. RBV explains how internal skills contribute to long-term competitive advantage, and it has been widely used in strategic management, entrepreneurship, and SME performance research.

Financial literacy is also considered an intangible strategic resource that satisfies the rare, valuable, unique and non-substitutable criteria. It is rare, as not all SME managers possess adequate financial skills; it is imitable because financial knowledge is often developed through personal experience and context-specific learning, making it difficult for competitors to imitate. Consequently, financial literacy strengthens an SME owner-manager's ability to manage working capital and adapt to financial challenges, and align financial decisions with strategic goals (Lusardi & Mitchell, 2014). According to RBV, this capability gives businesses a competitive edge by allowing them to manage their internal resources better than their competitors.

The theoretical framework also supports the idea that financial literacy moderates the relationship between WCM and SME performance. Wise (2013) found that WCM practices can have an independent impact on business success, but how well they work may depend on the financial well-being of the people running the company. For example, an SME manager who is financially literate would be better equipped to accurately predict cash flows or assess trade credit terms, thereby increasing the effectiveness of WCM tactics. Conversely, the potential benefits of WCM may be diminished by a lack of financial literacy, as poor interpretation of financial data can lead to less-than-ideal choices (Abdallah et al., 2024; Lusardi & Mitchell, 2014).

Thus, it makes conceptual and practical sense to incorporate financial literacy as a moderator.

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According to Lusardi and Mitchell (2014) and Eniola and Entebang (2017), SMEs need more than just access to WCM practices; they also need the know-how to use them efficiently. Few studies, such as Abeysekera & Wickramasinghe (2021) and Wise, (2013) have examined how financial literacy influences specific financial practices to impact corporate performance, despite the growing recognition of its importance. By experimentally examining how financial literacy influences the direction and strength of the WCM performance link within SMEs, especially in developing market environments where formal training and financial education are often lacking, this study aims to close that gap.

Moreover, empirical research increasingly emphasises the role of financial literacy in enabling SME owners to make better decisions, particularly in situations where access to outside financial counsel is limited. Fatoki (2014) found, for example, that SMEs in South Africa with higher financial literacy exhibited better risk assessment, timely loan repayment, and more effective financial planning. These skills have a direct impact on how SMEs manage working capital components, such as maintaining optimal inventory levels or effectively handling client credit (Abiodun & Amos, 2022). SMEs can make better operational and strategic decisions by leveraging financial expertise to analyse key working capital indicators, including cash flow projections and liquidity ratios.

Even as financial literacy receives more attention, little is known about how it can be used as a moderating factor in discussions of SME financial performance, especially when it comes to WCM. The majority of current research ignores financial literacy's possible interaction effects with particular financial practices and treats it as an independent predictor of performance or financial behaviour (Abeysekera & Wickramasinghe, 2021; Lusardi & Mitchell, 2014). To close that gap, this study examines the relationship between working capital practices and corporate performance, as well as the impact of financial literacy on this relationship. By doing this, the study advances a more sophisticated understanding of how internal resources, such as financial expertise, interact with financial strategies to influence the outcomes of SMEs. Scholars have called for more integrative models that capture the complexity of SME financial decision-making in real-world contexts, e.g., Sajuyigbe et al., (2024), and Nuwamanya (2021). Based on the theoretical underpinnings and empirical evidence reviewed, the study proposes the following hypotheses for testing:

i. H2: Financial literacy moderates the relationship between working capital management practices and firm performance.
ii. H2a: Financial literacy moderates the relationship between cash capital management practices and firm performance.
iii. H2b: Financial literacy moderates the relationship between receivable management practices and firm performance.
iv. H2c: Financial literacy moderates the relationship between payable management practices and firm performance.
v. H2d: Financial literacy moderates the relationship between inventory management practices and firm performance.

The literature reviewed emphasises the importance of effective working capital management practices in enhancing a firm's performance. However, it also reveals a gap related to limited empirical research on the moderating role of financial literacy in these relationships, particularly in developing economies where the financial decision-making capacity of SME owner-managers can vary considerably. To address this gap, the present study builds on existing theoretical foundations by proposing a conceptual model and formulating hypotheses that examine the direct effect of WCM practices on SM performance and the moderating influence of financial literacy.

3.0 Materials and Methods

This study examines the relationship between working capital management (WCM), financial literacy, and SME performance. It employed a cross-sectional survey design, utilising a quantitative research approach to collect and analyse the data. The data were collected from 300 SMEs, drawn

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from urban and semi-urban areas, using simple random sampling. This method ensured that each SME owner-manager had an equal chance of being selected and included in the sample. After determining the sample, a structured questionnaire was developed to gather relevant data on the core study variables. The structured questionnaires include sections on demographics, WCM practices, financial literacy, and SME performance, all of which are scored using established 5-point Likert scales, except for demographic information, which was used to gather data. Content validity was established through expert review by four subject matter experts, with academic and professional backgrounds in finance and SME management, of the adopted and modified items to ensure reliability. Furthermore, factor analysis was done to ensure construct validity, and internal consistency was confirmed with Cronbach's alpha values exceeding the 0.70 threshold. Table 1 presents a summary of the reliability results:

Table 1: Cronbach's alpha values

	Cronbach's alpha
CMPS	0.770
FL	0.734
FP	0.758
IMPS	0.745
PMPS	0.710
RMPS	0.856

Source: Research Finding 2024

The study's use of Partial Least Squares Structural Equation Modelling (PLS-SEM) enables the examination of the direct relationship and the moderating effect of financial literacy. PLS-SEM was selected due to its suitability in handling data that violates the assumption of multivariate normality. Moreover, the PLS–SEM is suitable for analysing complex models with both direct and moderating effects. Bootstrapping with 5,000 resamples was used to analyse the model's goodness of fit and the importance of its associations. The model fit and predictive relevance were assessed using standard PLS-SEM indicators, ensuring the robustness and validity of the findings.

4.0 Findings and discussion

This section presents the results of the empirical investigation, following data collection, model specification, and preliminary analysis. The analysis conducted using PLS-SEM includes an assessment of the measurement model to establish construct validity and reliability, followed by an evaluation of the structural model to test the proposed hypotheses and examine the moderating effect of financial literacy.

4.1 Demographic characteristics of respondents

In all, 300 self-administered questionnaires were distributed across three regions in Tanzania—Dar es Salaam, Arusha, and Kilimanjaro—to gather quantitative data for this study. Kilimanjaro, Arusha, and Dar es Salaam were selected because they represent Tanzania's leading urban and semi-urban economic centres and have a significant proportion of operating SMEs. A descriptive analysis of demographic factors reveals that only 25.7% of SME owner-managers were female, with the majority (74.3%) being male. Middle-aged individuals are the most engaged in entrepreneurial activities, with the majority of respondents (53.7%) falling within the age range of 36 to 55. Those aged between 18 and 35 (23.3%) and 56 and older (20.0%). SME ownership is primarily concentrated among individuals with basic to secondary educational backgrounds, as evidenced by the fact that the majority hold secondary education (42.0%), followed by primary education (32.3%), with smaller proportions holding certificates and diplomas (10.3% each) and university degrees (2.7%).

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Table 2: Demographic Profile of the Respondents

S/no	Details	Category	Frequency	Percentage
1	Gender	Male	223	73.4
		Female	77	23.6
		Total	***300***	***100***
2	Age	18-35	70	23.3
		36-55	161	53.7
		56-Above	69	23.0
		Total	***300***	***100***
3	***Education level***	Primary Education	97	32.3
		Secondary level	161	53.7
		Certificate level	31	10.3
		Diploma Level	31	10.3
		Bachelor degree	8	2.9
		Master's Degree	2	0.7
		Informal Education	2	0.7
		Others	3	1.1
		Total	***300***	***100***
4	Marital status	Married	198	66.0
		Single	62	20.7
		Divorced	18	6.0
		Widower	13	4.3
		Widow	9	3.0
		Total	300	100
5	Location	Dar-es-salaam	126	42.0
		Kilimanjaro	79	26.3
		Arusha	95	31.7
		Total	***300***	***100***

4.2 Evaluation of the measurement model

The measurement model demonstrated strong discriminant validity, convergent validity, and reliability. All of the constructs had excellent internal consistency and were over the 0.70 criterion for both Cronbach's Alpha and Composite Reliability (CR), confirming reliability (Hair, Babin, & Krey, 2017). As all the constructs have an Average Variance Extracted (AVE) above 0.50, the constructs managed to capture a significant amount of variance, thus establishing convergent validity. The heterotrait- Monotrait (HTMT) ratio of correlation helped to evaluate discriminant validity. Apparent conceptual differences across the conceptions were indicated by HTMT scores that stayed below the 0.85 threshold. Furthermore, cross-loadings further confirmed the appropriateness of item alignment with respective constructs, and Fornell-Larcker results demonstrated that the square root of each construct's AVE exceeded its correlations with other constructs.

Table 3: Construct Reliability

	Cronbach's alpha	Composite reliability (rho_a)	Composite reliability (rho_c)	Average variance extracted (AVE)
CMPS	0.770	0.806	0.848	0.584
FP	0.758	0.763	0.846	0.579
IMPS	0.745	0.767	0.852	0.658
PMPS	0.710	0.709	0.821	0.535
RMPS	0.856	0.889	0.902	0.699

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Source: Field Data Extracted from Smart PLS (2024)

Table 4: Heterotrait-Monotrait Ratio of Correlation

	CMPs	FP	IMPS	PMPs	RMPs
CMPS					
FP	0.266				
IMPS	0.453	0.420			
PMPS	0.191	0.763	0.351		
RMPS	0.033	0.157	0.115	0.136	

Source: Field Data Extracted from Smart PLS (2024)

4.3 Evaluation of the Structural Model

To guarantee validity and reliability, the measurement model inside the PLS-SEM framework was thoroughly examined in this investigation. Moreover, to produce more precise confidence intervals and evaluate the statistical significance of model parameters at a 0.05 significance level, the bias-corrected and accelerated (BCa) approach of bootstrapping with 5,000 subsamples was utilised. This reliable method allowed for the accurate evaluation of path coefficients by providing reliable estimates. The Standardised Root Mean Square Residual (SRMR) was used to evaluate the overall model fit. A satisfactory model fit was indicated by the SRMR score of 0.066, while R-squared values were used to measure the model's explanatory power. The values of R-squared vary from 0.36 to 0.47. Eight hypotheses were investigated, with an emphasis on the moderating effects of financial literacy, as well as the direct relationships between working capital management (WCM) practices and firm performance. This thorough examination validated the model's suitability for additional structural interpretation.

4.4 Influence of Working Capital Management Practices and Firm Performance

The goal of the study was to investigate how Working Capital Management Practices (WCMPs), categorised into four areas—cash management practices, payable management practices, receivable management practices, and inventory management practices—impact firm performance. The study developed four sub-hypotheses to do this: Cash management practices have a positive impact on firm performance, according to H1a; receivable management practices have a positive impact on firm performance, according to H1b; payable management practices have a positive impact on firm performance, according to H1c; and inventory management practices have a positive impact on firm performance, according to H1d.

4.4.1 Cash Management Practices (CMPs)

With a standard deviation of 0.042 and a path coefficient of 0.094, the link between Cash Management Practices (CMPs) and Firm Performance (FP) has a T-statistic of 2.260. The corresponding P-value of 0.024, which is below the threshold of 0.05, indicates the relationship is deemed statistically significant. This implies that, within the current model's framework, cash management practices have a direct impact on firm performance. Therefore, the results support hypothesis H1a.

4.4.2 Receivable Management Practices(RMPs)

With a standard deviation of 0.047 and a path coefficient of 0.062 for Receivable Management Practices (RMPs) and Firm Performance (FP), the T-statistic of 1.306 and P-value of 0.192 are higher than the traditional significance criterion of 0.05, when the T-statistic is less than 1.96. This link is, consequently, not statistically significant. This result suggests that receivable management practices may not be a key determinant of firm performance in the current context, as there is no evident direct

effect on performance within this model. Therefore, we reject the hypothesis H1 b.

4.4.3 Inventory Management Practices (IMPs)

With a standard deviation of 0.053 and a path coefficient of 0.157 for Inventory Management Practices (IMPs) and Firm Performance (FP), the T-statistic is 2.979. A highly significant link is indicated by the P-value of 0.000. Thus, effective inventory management is crucial for improving a company's financial performance, as evidenced by the significant positive impact that inventory management practices have on firm performance. Hence, it is accepted that inventory management practices have a positive impact on firm performance (H1c).

4.4.4 *Payable management practices*

With a standard deviation of 0.050 and a path coefficient of 0.506 for Firm Performance (FP) and Payable Management Practices (PMPs), the T-statistic is 10.161, and the P-value of 0.000 indicates that the association is statistically significant, and the T-statistic is significantly higher than the significance level of 1.96. Payable management practices, therefore, have a beneficial impact on firm performance, suggesting that more effective firm outcomes may follow from efficient payables management. It is acknowledged that payment management practices improve business performance (H1d). The results of hypothesis testing for the influence of working capital management practices on firm performance are shown in Table 5:

Table 5: Summary of the hypothesis

Hypothesis		Path	Beta (β)	t-value	P-value	Significance	Decision
H1a	CMPS→ FP	β3	0.094	2.260	0.024	Significant (p < 0.05)	Accepted
H1B	RMPS→ FP	β3	0.062	1.306	0.192	Significant (p < 0.05)	Rejected
H1c	IMPS→ FP	β5	0.157	2.979	0.003	Significant (p < 0.05)	Accepted
Hi, d	PMPS→ FP	β4	0.506	10.161	0.000	Significant (p < 0.05)	Accepted

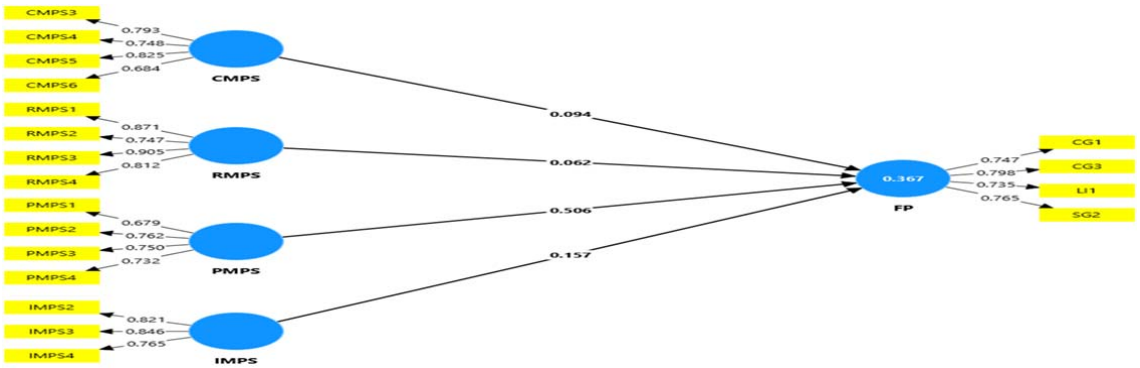

Figure 1: Structural Model for Direct Relationship between Working Capital Management Practices and Firm Performance

Table 6: Structural model coefficients for the direct effect of working capital management practices and firm performance

Original sample (O)		Sample mean (M)	Standard deviation (STDEV)	T statistics (|O/STDEV|)	P values
CMPS -> FP	0.094	0.100	0.042	2.260	0.024
IMPS -> FP	0.157	0.157	0.053	2.979	0.003
PMPS -> FP	0.506	0.508	0.050	10.161	0.000
RMPS -> FP	0.062	0.068	0.047	1.306	0.192

4.5 Moderating Influence of Financial Literacy on the Relationship between Working Capital Management Practices and Firm Performance

Financial literacy is essential for a corporation to manage its various financial processes effectively. These processes, which comprise inventory management, payable management, cash management, and receivable management, have a direct effect on a company's financial performance. The ability to make well-informed financial decisions based on a solid understanding of financial concepts may enhance the effectiveness of these management practices. Several financial management practices, such as inventory management practices (IMPs), payable management practices (PMPs), cash management practices (CMPs), and receivable management practices (RMPs), are examined in this study along with their effects on firm performance (FP) and the relationship between financial literacy and these practices.

4.5.1 Effect of Relationship between Financial Literacy (FL) and Cash Management Practices (CMPs) on Firm Performance (FP)

A p-value of 0.021, a T-statistic of 2.310, and a coefficient of 0.108 all showed a significant positive correlation between cash management practices and financial literacy. This implies performance: managers who possess greater financial literacy are more adept at handling cash flows, which is essential for preserving liquidity, fulfilling immediate commitments, and capitalising on investment opportunities. The idea that financial literacy improves cash management is supported by the apparent correlation between better financial success and the capacity to manage cash effectively. This finding is consistent with earlier studies (Chen & Volpe, 2020; Hassan, Le, & Hoque, 2021), which have demonstrated that financial literacy enhances cash flow management decision-making, reduces the risk of liquidity problems, and improves company financial performance. This research emphasises the importance of managers' financial education in streamlining cash management procedures and enhancing overall company performance.

4.5.2 Effect of Relationship between Financial Literacy (FL) and Receivable Management Practices (RMPs) on Firm Performance (FP)

The study found no statistically significant link between financial literacy and receivable management practices (RMPs), which contrasts with the favourable impact observed in cash management. In terms of enhancing firm performance, financial literacy has no discernible effect on receivables management, as indicated by the coefficient of 0.019 and the p-value of 0.635. This implies that although financial literacy could raise awareness of the value of receivables management, it lacks the practical abilities required to maximise working capital in this area. Receivable management is often impacted by external market dynamics, collection tactics, and customer payment patterns (Chen & Volpe, 2020; Hassan et al., 2021). Therefore, financial literacy alone may not be sufficient to increase the efficacy of receivables management, underscoring the importance of operational knowledge and external factors in this field.

4.5.3 Effect of Relationship between Financial Literacy (FL) and Payable Management Practices (PMPs) on Firm Performance (FP)

Additionally, with a p-value of 0.063 and a coefficient of -0.096, the analysis revealed no visible effect of financial literacy on payable management procedures. This finding suggests that there is no discernible relationship between financial literacy and effective payable management, or its impact on business success. Operational factors, including supplier relationships and cash flow restrictions, are more likely to impact payables management, which involves monitoring cash outflows and negotiating payment arrangements with suppliers (Moussawi, LaPlante, & Wang, 2020). The lack of a significant relationship suggests that operational factors, such as supplier interactions and negotiation skills, may be more important in determining the success of payable management, even though financial literacy may help managers understand the financial consequences of their payment decisions. Therefore, improving payment management techniques does not seem to be

strongly impacted by financial literacy.

4.5.4 Effect of Relationship between Financial Literacy (FL) and Inventory Management Practices (IMPs) on Firm Performance (FP)

Similarly, a p-value of 0.242 and a negative coefficient of -0.096 indicated that there was no significant correlation between inventory management procedures (IMPs) and financial literacy. This implies that inventory management, which is typically influenced by operational factors such as supply chain efficiency, production cycles, and demand forecasts, is not directly impacted by financial literacy. Financial literacy does not give managers the specialised operational expertise needed to maximise inventory management, even though it may increase their awareness of the significance of cost control and inventory turnover (Kassim, Zubieru, & Antwi, 2015). The direct applicability of financial literacy in this field is probably diminished by the practical and technological character of inventory management procedures, which incorporate supply chain dynamics and market volatility.

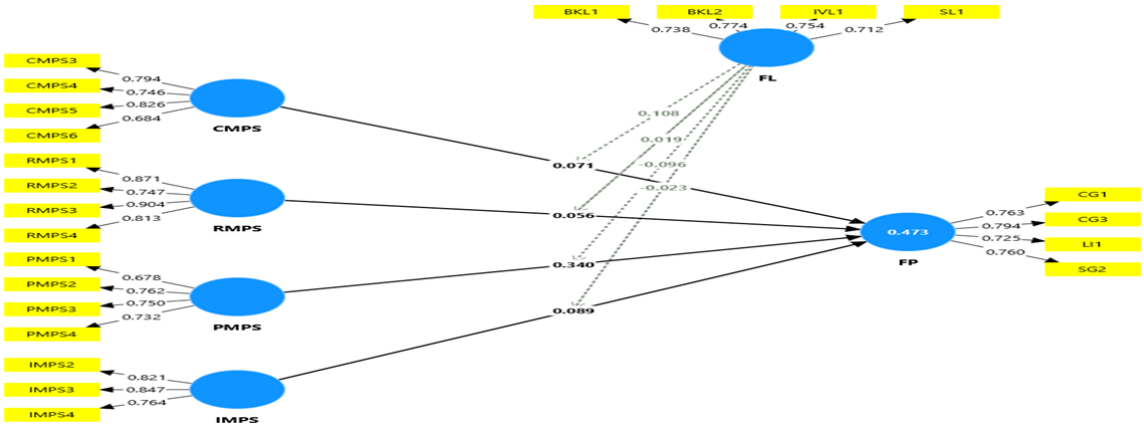

Figure 2: Structural Model for the Moderating Effect of Financial Literacy on the Relationship between Working Capital Management Practices and Firm Performance

Table 7: Structural Model Coefficient for the Moderating Effect of Financial Literacy on the Relationship between Working Capital Management Practices and Firm Performance

	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (|O/STDEV|)	P values
FL x CMPS -> FP	0.108	0.109	0.047	2.310	0.021
FL x IMPS -> FP	-0.023	-0.023	0.055	0.409	0.683
FL x PMPS -> FP	-0.096	-0.096	0.051	1.857	0.063
FL x RMPS -> FP	0.019	0.020	0.040	0.475	0.635

Source: Field Data (2024)

Building on the results, the following section discusses the findings in relation to the theoretical framework and prior research, offering insights into their implications for both theory and practice.

5.0 Discussion

A path coefficient of 0.094, a T-statistic of 2.260, and a p-value of 0.024—all below the traditional significance threshold of 0.05—indicate that Cash Management Practices (CMPs) have a statistically significant effect on Firm Performance (FP), according to the structural model analysis. The result is consistent with that of (Deloof, 2003; Mathuva, 2009). This finding validates how

efficient cash management, including planning, managing surpluses or shortages, and keeping optimal cash balances, improves a company's business outcomes, supporting hypothesis H1a. (Afrifa & Padachi, 2016). Similarly, with a path coefficient of 0.157, a T-statistic of 2.979, and a highly significant p-value of 0.003, Inventory Management Practices (IMPs) exhibit a substantial positive correlation with business success, which aligns with the study (Pillai, 2010). This finding supports the idea that reasonable inventory control improves operational effectiveness and financial outcomes by reducing expenses and guaranteeing product availability, and it also validates hypothesis H1c.

On the other hand, a low path coefficient of 0.062, a T-statistic of 1.306, and a P-value of 0.192 show that Receivable Management Practices (RMPs) do not have a statistically significant impact on firm performance. The result is consistent with that of García-Teruel and Martínez-Solano (2007). These findings lead to the rejection of hypothesis H1b, suggesting that receivables are not a significant factor in firm performance in the current environment. The results of the interviews offer more perspective, even though the quantitative data show an insignificant relationship between receivable management and firm Performance. SMEs' owner-managers rarely extend credit, typically only to well-known and reputable customers. As a result, accounts receivable periods typically do not exceed 30 days and are implemented informally and infrequently. It is challenging to quantify these activities systematically, as they largely depend on human relationships and trust rather than established processes. This could be the reason why the model indicates that receivable management does not affect performance. The most significant factor, however, is Payable Management Practices (PMPs), which has a significant path coefficient of 0.506, a very high T-statistic of 10.161, and a P-value of 0.000. These results align with studies such as Deloof (2003), which suggest that strategic and disciplined payables management significantly improves firm performance, most likely through enhanced cash flow and stronger supplier relationships, and thus provide compelling evidence in support of hypothesis H1d. Overall, the results highlight that not all aspects of working capital have an equal impact on business success, with cash, inventory, and payables being more important in this study than receivables.

Financial literacy can have a significant impact on the effectiveness of specific financial techniques, particularly in cash management, as evidenced by its moderating role in the relationship between working capital management practices and firm performance. A statistically significant relationship exists between cash management practices (CMPs), financial literacy (FL), and firm performance (FP) ($p = 0.021$, $t = 2.310$, coefficient = 0.108). This suggests that managers who are financially educated are better equipped to monitor liquidity, make adequate cash allocations, and capitalise on investment opportunities, all of which enhance business outcomes. Financial literacy improves a manager's ability to understand financial data, make wise cash flow decisions, and reduce liquidity risks, as shown by (Daskalakis, 2025). The claim that improving managerial financial education can result in more cautious cash planning and execution, which directly improves financial performance, is supported by (Heryanto & Leng, 2021).

A p-value of 0.635 and a coefficient of 0.019, on the other hand, suggest that there is no statistically significant moderating effect of financial literacy on receivable management practices (RMPs). Although it is theoretically expected that financially literate managers would better understand the importance of prompt collections, the impact on receivables seems to be relatively small. This could be because economic conditions, industry-specific collection tactics, and customer behaviour have a greater impact on receivable performance (Albuquerque, Ramadorai, & Watugala, 2019; Moussawi et al., 2020). The outcome suggests that without supplementary operational measures, such as credit policy formulation, enforcement, and negotiating techniques, financial knowledge alone is insufficient to ensure effective receivables management. Additionally, the analysis reveals that financial literacy has no significant effect on payable management ($p = 0.063$, $\beta = -0.096$) or inventory ($p = 0.242$, $\beta = -0.096$), underscoring the minimal influence of financial education on domains influenced by supplier dynamics, market conditions, and logistics.

The operational complexity and external interdependence inherent in inventory and payment management techniques are further highlighted by the lack of a moderating influence of financial literacy. For example, successful inventory management depends on supply chain coordination,

procurement cycles, and precise demand forecasting—skills that are frequently distinct from fundamental financial knowledge(Chen & Volpe, 2020; Moussawi et al., 2020). Similarly, financial literacy may not always be as important as negotiation skills and industry-specific experience when it comes to successful payable management, which often depends on factors such as supplier relationships, bargaining strength, and cash availability. Financial literacy does not always convert into operational competence in managing inventories and payables, even if it may increase understanding of financial commitments and working capital implications. These results highlight that to effectively impact business performance through working capital management, a wider range of skills, beyond financial literacy, is required.

6.0 Conclusion and Recommendations

This study provides empirical evidence that the performance of small and medium-sized enterprises (SMEs) in developing nations is significantly enhanced by efficient working capital management (WCM) practices, specifically cash management, inventory management, and payables management. In this case, receivables management did not appear to have a substantial impact on firm performance, as anticipated. Crucially, the study reveals that financial literacy plays a significant moderating role, significantly amplifying the beneficial impact of cash management on business success. This emphasises how having financial knowledge helps SME owners better manage cash, evaluate risks, and make well-informed investment decisions—especially in settings with limited resources. Theoretically, this research extends existing working capital management practices by integrating the dimension of financial literacy, providing a comprehensive understanding of the performance drivers of SMEs. Furthermore, the findings underscore the pressing need for targeted financial education programmes and the adoption of digital tools to enhance working capital management practices. Ensuring a strong supplier relationship as a strategic way to SMEs' competitiveness.

By incorporating the cognitive aspect of financial literacy, this study theoretically expands on current working capital management frameworks, providing a more comprehensive understanding of the factors that contribute to SME success. Practically, the results underscore the importance of tailoring financial education programs and leveraging digital tools to optimise working capital management. Furthermore, developing solid supplier relationships is a strategic approach to boost the resilience and competitiveness of SMEs.

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